AUSTRALIAN FOOD & GROCERY COUNCIL

AFGC SUBMISSION

Food and Grocery Code of Conduct Review 2023-24 – Interim Report

May 2024

PREFACE

The Australian Food and Grocery Council (AFGC) is the leading national organisation representing Australia's food, beverage and grocery manufacturing sector.

With an annual turnover in the 2021-22 financial year of $144 billion, Australia's food and grocery manufacturing sector makes a substantial contribution to the Australian economy and is vital to the nation's future prosperity.

The diverse and sustainable industry is made up of over 17,000 businesses ranging from some of the largest globally significant multinational companies to small and medium enterprises. Each of these businesses contributed to an industry-wide $3.2 billion capital investment in 2021-22.

Food, beverage and grocery manufacturing together forms Australia's largest manufacturing sector, representing over 32 per cent of total manufacturing turnover in Australia. The industry makes a large contribution to rural and regional Australia economies, with almost 40 per cent of its 271,000 employees being in rural and regional Australia.

It is essential to the economic and social development of Australia, and particularly rural and regional Australia, that the magnitude, significance and contribution of this industry is recognised and factored into the Government's economic, industrial and trade policies.

Throughout the COVID19 pandemic, the food and grocery manufacturing sector proved its essential contribution to Australian life. Over this time, while our supply chains were tested, they remain resilient but fragile.

The industry has a clear view, outlined in *Sustaining Australia: Food and Grocery Manufacturing 2030,* of its role in the post-COVID19 recovery through an expansion of domestic manufacturing, jobs growth, higher exports and enhancing the sovereign capability of the entire sector.

This submission has been prepared by the AFGC and reflects the collective views of the membership.

EXECUTIVE SUMMARY

The AFGC welcomes the Independent Review of the Food and Grocery Code of Conduct Interim Report.

The Code was introduced in 2015 to address the fundamental imbalance in market power that exists between supermarket retailers, wholesalers and their suppliers and supports the retention of this focus. The AFGC commends all Code signatories for their commitment to the Code and notes that large and small suppliers have indicated that the Code has had a positive effect on signatories' behaviours over this time. However, there is still room for further improvement, based on evidence from members as well as reports from the Independent Reviewer Chris Leptos.

One of the major shortcomings of the current arrangements is the fear of retribution suppliers face in raising a complaint. The AFGC welcomes the Interim Report's recognition that this fear is real and that additional mechanisms are needed in the Code to provide protections against retribution for suppliers wishing to escalate to a formal complaint. In addition to these protections, the AFGC supports the Interim Report's recognition that the shift to a mandatory code requires supplementary quick, low-cost alternatives to court and ACCC based disputes processes. It is vital that formal complaints can be arbitrated by an independent party, should the supplier choose. To this end, the AFGC strongly supports the Interim Report encouraging signatories to agree to insert, into their grocery supply agreements, a model of independent arbitration with the ability to pay up to $5 million in reparations.

The AFGC remains of the view that despite these recommendations which strengthen the formal complaints system, the more escalatory a complaints process, the more fear there is in using it. It is therefore critical that there are mechanisms in place for suppliers to confidentially raise informal concerns/ complaints with an independent party who can identify systemic patterns of behaviour and raise these with signatories on behalf of industry rather than an individual supplier.

While the Code Arbiters have more recently played a role in hearing informal complaints, this needs to be codified and concerns remain regarding their appointment and remuneration by the retailers. The AFGC therefore supports the Interim Report's recommendation that the Code Supervisor be tasked with hearing and reporting on informal complaints, in addition to formal complaints, and that reporting needs to occur more frequently than annually. The power of informal, independent and confidential complaint mechanisms should not be underestimated.

In addition to these architectural issues, the AFGC's other priority is the strengthening of some of the specific provisions within the existing code, and on which this and our former submission provide views.

The AFGC notes that concerns have been raised regarding the ability of retailers to contract out of certain provisions. This submission proposes a way forward that seeks to strike the balance between responding to concerns regarding potential pressure that may be applied to suppliers to contract out versus the risk of unintended commercial consequences from the removal of contracting out clauses.

Finally, the AFGC would like to thank Dr Emerson and the Treasury Secretariat for your thoroughness in undertaking this review and the serious consideration you have given to suppliers' concerns regarding retribution. We remain ready to assist as you finalise the review.

SECTION 1 – FIRM RECOMMENDATIONS

A MANDATORY CODE WITH A $5B THRESHOLD

This section addresses the following recommendations from the Interim Report:

Recommendation 1. The Food and Grocery Code of Conduct should be made mandatory.

Recommendation 2. All supermarkets that meet an annual revenue threshold of $5 billion (indexed for inflation) should be subject to the mandatory Code. Revenue should be in respect of carrying on business as a 'retailer' or 'wholesaler' (as defined in the voluntary Code). All suppliers should be automatically covered.

The AFGC greets the recommendation to move to a mandatory Code with cautious support. While we acknowledge and respect the decision to mandate the Code, it is necessary to emphasise the importance of ensuring that suppliers are not disadvantaged by the consequent adjustments to the Code's dispute resolution mechanisms. This subject is covered in greater detail in Section 2 below.

The AFGC supports the concept of an annual revenue threshold as the most appropriate measure to determine whether a retailer or wholesaler should be covered by the Code. The most salient question is whether $5 billion is the most suitable threshold. In addition to the four current signatories to the voluntary Code, the AFGC considers that the biggest priorities with regard to coverage should be Costco and Amazon.

On current trends Costco, which reported $4.4 billion in sales for 2023,[1] could be assumed to soon cross the proposed $5 billion threshold. This is of increasing importance due to the growing volume of complaints raised by AFGC members about Costco's mistreatment of suppliers.

Amazon is projected to hit $5.5 billion in Australian turnover this financial year.[2] And although the proportion of food and grocery sales in this figure is unknown, Amazon has clear ambitions to grow its share of Australia's food and grocery retail market, and has increased its range of household grocery products accordingly.[3] While, for the time being, Amazon remains a comparatively small food and grocery retailer in the Australian market, the AFGC considers that its international track record when dealing with suppliers is a significant cause for concern. In the British Grocery Code Adjudicator's annual supplier survey for 2023, respondents rated Amazon as by far the worst retailer with regard to compliance with the

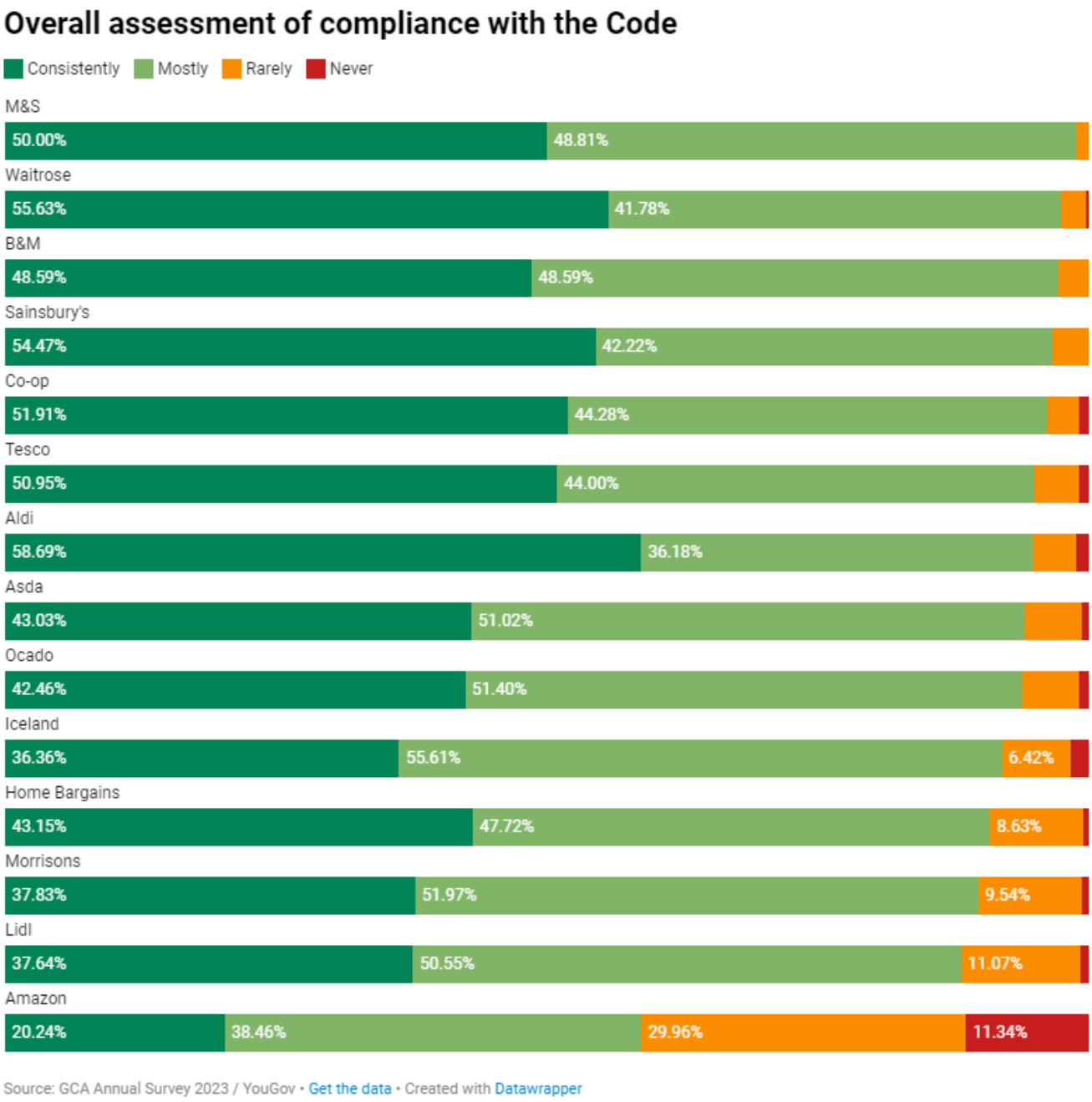
[1] See https://www.theaustralian.com.au/business/retail/costco-a-new-retail-force-as-australian-sales-race-towards-5bn/news-story/8b4b6f83f501104643d6a335db52628a

[2] See https://www.afr.com/companies/retail/amazon-inches-to-5-5b-australian-milestone-20230605-p5de19

[3] See https://thenightly.com.au/business/why-amazons-huge-growth-in-australia-has-put-coles-and-woolworths-on-notice-c-14370297

Groceries Supply Code of Practice.[4] This is visualised in Figure 1 below. Anecdotally, AFGC is aware of concerns that some elements of Amazon's terms and conditions are at odds with the Code.

Figure 1 – British Grocery Code Adjudicator annual supplier survey results, 2023



[4] See https://www.thegrocer.co.uk/online/no-excuse-for-amazons-shocking-first-outing-on-supplier-ranking/680257.article

https://www.retailgazette.co.uk/blog/2023/12/amazon-threatens-delists-suppliers/

Noting the above, the AFGC considers that the threshold should be set at a level that would ensure Costco and Amazon would be covered by the mandatory Code.

Finally, the AFGC desires clarification of the intent behind the last sentence in Recommendation 2 that "all suppliers should be automatically covered". If the intent is that all suppliers, in doing business with a retailer or wholesaler, are automatically entitled to protection under the Code, then the AFGC is supportive.

ADDRESSING THE FEAR OF RETRIBUTION

This section addresses the following recommendations from the Interim Report:

Recommendation 3. The Code should place greater emphasis on addressing the fear of retribution. This can be achieved by including protection against retribution in the purpose of the Code and by prohibiting any conduct that constitutes retribution against a supplier.

Recommendation 5. To guard against any possible retribution, supermarkets covered by the mandatory Code should have systems in place for senior managers to monitor the commercial decisions made by their buying teams and category managers in respect of a supplier who has pursued a complaint through mediation or arbitration.

Recommendation 6. A complaints mechanism should be established to enable suppliers and any other market participants to raise issues directly and confidentially with the ACCC.

The AFGC hails the Interim Report's recognition of the fear of retribution as one of the key dynamics within supplier-retailer relationships, and applauds the recommendation to increase the Code's emphasis on addressing supplier fears. This is a problem with both normative and architectural dimensions. Regarding the former, fear of retribution from suppliers' major trading partners, with potential business-ending consequences, is deeply ingrained within the supplier community and changing these norms will be neither quick nor easy. One of the principal challenges for the current review of the Code will be to make consequential changes to the Code's architecture that can, over time, contribute to changing supplier conceptions and behavioural norms by improving confidence in the Code, such that suppliers feel they can stand up for their rights under the Code with a reduced level of fear.

The AFGC considers that there are several architectural changes to the Code that could advance this objective of gradually breaking down supplier fears.

Purpose statement

At the highest level of Code architecture, the AFGC supports the inclusion of a new statement within Provision 2 – Purpose of code, declaring that addressing suppliers' fear of retribution is one of the Code's core purposes. This would signify the centrality of addressing supplier fears within the updated Code, and would need to be complemented by other amendments.

Introducing new protections

The AFGC supports the inclusion of a new specific provision that provides high level protection against retribution, akin to the good faith provision. Although Provision 6B (3) (d) already refers to retribution as

conflicting with good faith, a specific provision would have the effect of complementing the higher-level purpose statement with an additional, more specific, protection to increase the Code's emphasis on protecting suppliers against retribution.

Penalties for retribution

As noted in Section 3 below, the AFGC recommends that retribution against a supplier be subject to the highest penalties to be introduced under the revised Code.

Retailer monitoring requirements

The AFGC supports the recommendation to oblige retailers to institute their own monitoring practices, much as Woolworths already have in place with their Complaints Integrity Policy. However, we recommend broadening a retailer's obligation to monitor commercial decisions made concerning a company that had followed any avenue of formal complaint, even if that complaint did not ultimately result in mediation or arbitration.

Guidance on what constitutes retribution

One of the principal challenges associated with improving the Code's protections against retribution is that it is often hard to distinguish between retributive actions and commercial legitimacy. Retribution will rarely be directly and immediately linked to a supplier's request, complaint or resistance to a retail buyer in such a way as to clearly demonstrate causation. However, suppliers who have 'upset' a retail buyer by not acceding to demands, even demands that might constitute a clear breach of the Code, often report the emergence of new 'frictions' in a commercial relationship which they perceive as retribution.

Due to the number of commercial levers controlled by the retailer, such 'frictions' can take many forms: reduced promotional activity versus a competitor brand, incremental adjustments to on-shelf positioning to the supplier's detriment, or a reduced willingness to consider new product ranging. Such actions can occur weeks or months after the supplier's complaint or lack of agreement to a demand, and may be directed at other products of the supplier to those that were at the centre of the dispute. In some instances, suppliers will report that a retail buyer may deliver a verbal 'confirmation' that a particular action was intended as 'punishment' for the supplier, but a buyer would seldom be so naïve as to communicate this message in writing. In this environment of ambiguity, in which multiple interpretations of a given commercial decision are possible, it is often difficult to satisfactorily demonstrate retributive conduct.

This is a complex matter that is not easily addressed. However, in accordance with the recommendation to produce a suite of guidance documents to define what would be considered a breach of the Code (see Section 2 below), the AFGC would strongly recommend:

- a guidance document be produced to define what actions would constitute retribution under the Code, and
- that this definition be an expansive one that takes into account the real-world manifestations of retailer retributive conduct.

OTHER COMMENTS

This section addresses the following recommendations from the Interim Report:

Recommendation 4. As part of their obligation to act in good faith, supermarkets covered by the mandatory Code should ensure that any incentive schemes and payments that apply to their buying teams and category managers are consistent with the purpose of the Code.

Recommendation 8. A Code Supervisor (previously the Code Reviewer) should produce annual reports on disputes and on the results of the confidential supplier surveys.

Recommendation 10. Penalties for non-compliance should apply, with penalties for more harmful breaches of the Code being the greatest of $10 million, 10 per cent of turnover, or 3 times the benefit gained from the contravening conduct. Penalties for more minor breaches would be 600 penalty units ($187,800 at present).

The AFGC welcomes the Interim Report's emphasis on the power of incentives, and its recognition that category manager and buying team incentives can prioritise retailer profits over the treatment of suppliers. We support the concept of retailer buying teams' and category managers' key performance indicators, incentive schemes or any behavioural inducements aligning with the intent of the Code. The AFGC considers that this intent could best be realised if supported by an additional obligation for retailers to publish their incentive schemes, in order to verify their alignment with the Code, and help engender trust and certainty within the supplier community.

The AFGC also welcomes the recommended reporting obligations for the Independent Reviewer/Code Supervisor, noting their contribution to promoting transparency and accountability, and the usefulness of the annual reports that have been produced by the Independent Reviewer in recent years. This is covered in Section 2.

Finally, the AFGC supports the prospect of penalties applying to breaches of the Code – this subject is discussed in greater detail in Section 3.

SECTION 2 – DRAFT RECOMMENDATIONS

DISPUTE RESOLUTION

This section addresses the following recommendations from the Interim Report:

Recommendation 7. The mandatory Code should include informal, confidential and low-cost processes for resolving disputes, and provide options for independent mediation and arbitration. This could be achieved by:

> ***Adopting the dispute resolution provisions of other industry codes, which provide for independent mediation and arbitration;***
>
> ***Allowing for supermarket-appointed Code Mediators to mediate disputes, where agreed by the supplier, and recommend remedies that include compensation for breaches and changes to grocery supply contracts; and***
>
> ***Allowing suppliers to go to the Code Supervisor (previously the Code Reviewer) to make a complaint; to seek a review of Code Mediator's processes; or to arrange independent, professional mediation or arbitration.***

Supermarkets are encouraged to commit to pay compensation of up to $5 million to resolve disputes, as recommended by the Code Mediator and agreed by the supplier, or as an outcome of independent arbitration.

It also addresses the following questions from the Interim Report:

Question 3. Do the dispute-resolution arrangements outlined in this Interim Report allow for low-cost and quick resolution of complaints without fear of retribution? Provide reasons for your response.

Question 4. Are there alternative or additional mechanisms that could improve dispute resolution under a mandatory Code?

Regarding dispute resolution under the Code, the AFGC continues to maintain principles-based objectives. A suitable dispute resolution framework would be:

- quick
- confidential
- low-cost
- binding
- low-friction (i.e. not damaging to commercial relationships)

and have the capacity to:

- deliver compensation, and
- investigate systemic patterns of behaviour.

The Interim Report acknowledges the AFGC's concern that a mandatory code which limits dispute resolution processes to the ACCC or formal court system would not be effective. The AFGC supports the recommendation to address these concerns through the addition of independent arbitration of formal complaints, and an independent informal complaints mechanism. The AFGC notes that independent arbitration through a mandatory code needs to be consensual and strongly urges the retailers to agree to a model of independent arbitration in grocery supply agreements, including the payment of up to $5 million in reparations when recommended via independent arbitration.

Should the retailers not agree to this, then it begs the question why they would agree to someone they appoint (i.e. the Code Arbiters/Mediators) determining reparations up to $5 million, but not agree to an independent arbiter recommending the same. This seems to highlight the fundamental issue: a perception that the retailers want to control the arbitration process.

While the AFGC supports the continuation of the retail appointed Code Arbiters in their new capacity as Code Mediators, we note they are hamstrung by suppliers' perceptions of bias or fear of an inadvertent breach of confidentiality. Despite the AFGC's best efforts to encourage members with concerns to engage with the Code Arbiters, even informally, some suppliers continue to be reluctant to do so out of concerns over the Code Arbiters' independence. The AFGC therefore supports providing suppliers with options for independent mediation or arbitration.

The AFGC maintains that the most effective route to improving retail behaviours is an independent approach to hearing *informal* complaints, which typically involves identifying and investigating systemic patterns of concerning behaviour, deidentifying the concerns, and discussing them with the relevant retailer. We consider that this provides the most demonstrably-effective means of achieving real behavioural change within the sector.

To this end, the AFGC supports the proposals for a direct, confidential complaints line to the ACCC; and the ability of the Code Supervisor to directly hear informal or formal complaints and raise systemic issues with the retailers, Code Mediators or the ACCC.

Consequently, and with reference to the AFGC's initial submission, we propose the following additions to further improve the proposed dispute resolution framework:

Code Arbiters/Mediators

- Developing guidelines for how Code Arbiters/Mediators are expected to conduct their affairs, to promote consistent standards of conduct and guard against their functioning as an additional 'line of defence' for their respective retailer.
- Incorporating the ability for Code Arbiters/Mediators to hear informal complaints, per the recommendations from the Dispute Resolution Review 2023.

Independent Reviewer/Code Supervisor

- Enabling the Independent Reviewer/Code Supervisor to receive informal complaints, anonymously if required, and identify systemic issues that are impacting numerous suppliers. Ideally this would include a dedicated 'complaints portal' through which suppliers can provide confidential information, as well as via direct contact.

- Empowering the Independent Reviewer/Code Supervisor to direct the Code Arbiters/Mediators to investigate and report on identified systemic issues, and propose remedial action where appropriate. This would represent a low cost, informal and minimally confrontational approach to assist in breaking down supplier reluctance to raise issues.
- Authorising the Independent Reviewer/Code Supervisor to recommend that a retailer remove their Code Arbiter/Mediator in circumstances where the latter is not fulfilling their duties or operating in the spirit of the FGCC. This would ensure Code Arbiters/Mediators were meeting their responsibilities and help to increase supplier confidence in the Code's dispute resolution framework.
- Enabling the Independent Reviewer/Code Supervisor to hear a merits review appeal of a Code Arbiter's/Mediator's decision, in order to promote further accountability for Code Arbiters'/Mediators' conduct.
- Noting the new designated complaints function within the Australian Competition and Consumer Commission, the AFGC would support the Independent Reviewer/Code Supervisor taking on the role of designated complainant for the food and grocery sector.

Reporting and guidance material

The AFGC supports the Interim Report's recommendations for the Independent Reviewer/Code Supervisor to continue reporting on disputes, noting the intent for this reporting to include informal complaints. To account for the fast-moving nature of commercial practices in the food and grocery sector, we would recommend shortening the reporting period to quarterly to ensure the latest report's currency, and would further recommend that the reporting obligations cover systemic issues that have been identified since the last report.

Finally, the AFGC strongly supports the recommendation for the Independent Reviewer/Code Supervisor to produce a suite of guidance materials to aid consistent interpretation of the Code's obligations by all retailers, Code Arbiters/Mediators and suppliers.

MINIMUM STANDARDS AND 'OPT OUT' CLAUSES

This section addresses the following recommendations from the Interim Report:

Recommendation 9. Specific obligations under the Code should set minimum standards that cannot be contracted out of in grocery supply agreements or otherwise avoided.

The AFGC has engaged deeply with our membership in order to assess the potential consequences of removing the Code's 'opt out' clauses. Following this consultation, the AFGC remains concerned about the potential for unintended consequences for suppliers from the removal of opt out provisions.

An example of the potential unintended commercial consequences from removing the opt out clauses can be illustrated through an examination of 18 – Funding promotions. The way in which this provision is structured prohibits a supplier being "directly or indirectly required" to partially or fully fund promotions, unless it is permitted under a grocery supply agreement and the funding is reasonable in the circumstances. In this case, removing the opt out clause would have enormous ramifications because in virtually every case a promotion will be at least partially funded by a supplier. While the AFGC does hold

concerns about broader patterns of promotional costs and benefits between suppliers and retailers, which can place a disproportionate share of costs on suppliers and secure disproportionate benefits for retailers, this is not an issue that can be appropriately addressed by changing the dominant promotional mechanic. Suppliers often benefit from, and therefore want to participate in, promotions. Removing this opt out clause would benefit neither suppliers nor retailers.

The AFGC is, however, sympathetic to concerns that retailers could pressure suppliers to agree to opt outs, or not clearly communicate the consequences of a decision to opt out (particularly in the case of smaller suppliers). While the opt out clauses contain protections that include a reasonableness test, the AFGC recommends that an additional provision be inserted into the Code that:

- prohibits a retailer from pressuring a supplier to agree to opt outs
- makes clear to the supplier the consequences of opting out
- provides an avenue for the supplier to withdraw from an opt out at any time, and
- requires retailers to report to the Independent Reviewer/Code Supervisor how frequently they have exercised opt-out options during the reporting period.

This simple approach seeks to strike the balance between concerns with opt outs and unintended commercial consequences from their removal.

SECTION 3 – CONSULTATION QUESTIONS

GOOD FAITH OBLIGATIONS

This section addresses the following question from the Interim Report:

Question 2. Are there reasons why the good faith obligation should not be extended to suppliers? Please detail your reasons, including any case studies that might demonstrate your concerns.

The AFGC firmly opposes the extension of good faith obligations to suppliers, on grounds of principle and practicality. Regarding the former, it is necessary to go back to the original focus of the Code, which, according to the initial Explanatory Statement,[5] was concerns regarding "the conduct of retailers (in particular, supermarkets) towards their suppliers". Its focus is on discouraging supermarket retailers from wielding their market power to the detriment of suppliers. Consequently, and appropriately, its obligations are on the retailers who possess market power.

The AFGC is greatly concerned about providing retailers with 'hooks' into suppliers in a manner that may inadvertently increase their already disproportionate negotiating power. AFGC members have raised serious concerns that retailers could weaponise any additional obligations extended on to suppliers, by accusing suppliers who were not acquiescent of not acting in good faith. Hypothetical examples include:

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5 https://www.aph.gov.au/Parliamentary_Business/Committees/Senate/Economics/Food_and_Grocery_2015/Regulation_Explanatory_Statement

- a supplier being accused of not acting in good faith for an unwillingness to consider reducing their wholesale price
- a supplier being accused of not acting in good faith for not divulging commercially-sensitive information as part of a cost price increase process, or
- a supplier being accused of not acting in good faith for rejecting a retailer request for deeper promotional funding in response to a competitor.

In short, an extension of the obligation on to suppliers could easily become additional leverage for retailers who already enjoy a negotiating advantage by virtue of their market power, putting suppliers on to the back foot and potentially working at cross-purposes to the remainder (and intent) of the Code.

PROVISIONS

This section addresses the following question from the Interim Report:[6]

Question 7. Do any of the obligations under the Code need strengthening to better protect suppliers?

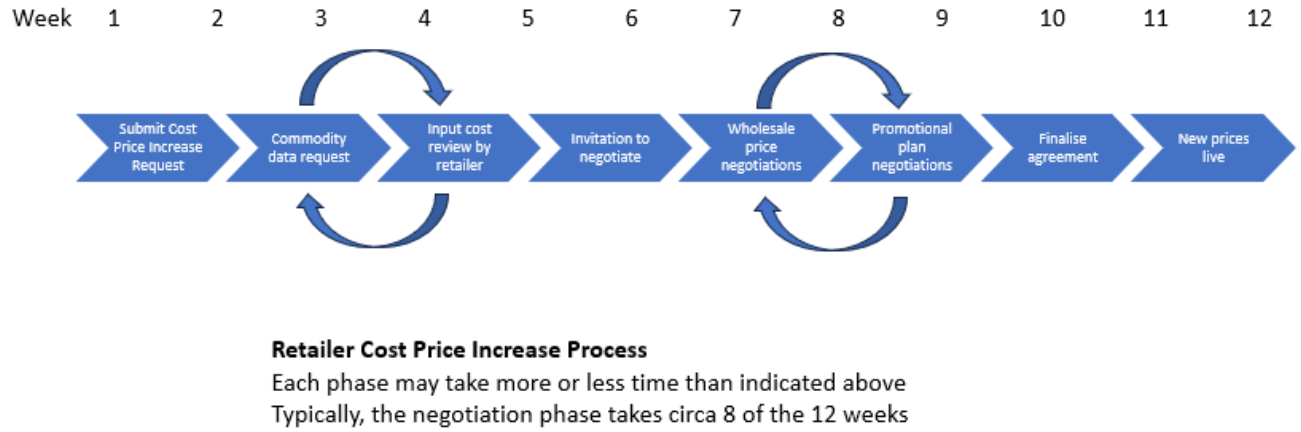
27A – Price increases

Introduced during the 2018 Code Review, the price increase provisions seek to establish a minimum standard of conduct for retailers when dealing with suppliers about price. The objective is to ensure that one party does not bear an uneven burden of risk, relative to the other party, due to an imbalance of bargaining power. At the time, the reviewer, Graeme Samuel, suggested that a future review of the Code should consider the effectiveness of the price increase provisions, and whether further regulation of the price rise process may be required.

The major retailers are effectively the gatekeepers of food and grocery prices. This is not only the case for shelf prices, which are rightfully under their full control, but also to a large extent for wholesale prices. The major retailers exercise a disproportionate influence over the wholesale prices charged by suppliers by virtue of being the most significant buyers. Any supplier seeking to increase the wholesale price for their goods must navigate a price increase process that is controlled by the retailer, who can ultimately accept or reject a supplier's proposed price.

[6] Please note that although much of this content has been reproduced from the AFGC's initial submission, this represents an updated list of provision-specific recommendations reflecting AFGC member consultation undertaken in recent weeks. It supersedes the recommendations made in the AFGC's initial submission.

Figure 2: Retailer cost price increase process



Retailer Cost Price Increase Process
Each phase may take more or less time than indicated above
Typically, the negotiation phase takes circa 8 of the 12 weeks

As Figure 2 shows the retail cost price increase process is lengthy and typically takes at least three months. During price negotiations, the retailer generally continues to order at the 'old' price. Suppliers, meanwhile, can only start to recover their increased costs from retailers upon conclusion of the negotiation process. In a rapidly inflationary environment, such as the last few years, this has been difficult for suppliers as their costs were rising far quicker than their wholesale prices.

In many cases, suppliers face extensive and intrusive questioning from retailers, who ask suppliers to justify why the price increase is necessary, requesting potentially sensitive details such as invoices to assess which input costs have gone up and by how much. Supplier concerns with revealing cost information is twofold. Firstly, unlike retail, the supply of food and groceries is a competitive market and it is this competition between suppliers that ensures wholesale prices are competitive, not excessive. The retailers checking and effectively constraining wholesale prices is purely driven by the retailer's desire to maintain their own competitive retail position, by putting pressure back on the supply chain. Secondly, in many instances, the retailer provides private label products and hence is a competitor to suppliers of branded products. Providing commercially sensitive information could have negative commercial consequences for the supplier and potential anti- competitive effects.

As part of the cost price increase process, retailers place conditions of acceptance on the supplier during the negotiation process, typically financial support. Table 1 contains the results of a recent member survey, conducted by AFGC regarding the additional margin or promotional support suppliers were requested to provide as a condition of the retailer accepting the price increase. This negates the impact the cost price increase has on recouping input cost increases. Suppliers also report that failure to agree to retailer requests for additional financial support can result in the retailer ceasing all previously agreed promotional activity and limiting other mechanisms for delivering value to the consumer and volume to both the retailer and supplier.

Table 1: Conditions of price increase acceptance from major retailers, January 2024 AFGC survey

Retail Ask	Retailer A	Retailer B
Additional margin	47%	**72%**
Additional promotional support	**60%**	54%
Other financial support	47%	39%
Agreement not to pursue additional price increases	24%	29%
Exclusivity	9%	11%
None	18%	12%
Other	13%	8%

The current provision in the Code relating to the cost price process requires the retailer or wholesaler to respond to the supplier within thirty days, either:

- accepting the price increase,
- accepting the increase but not the amount, or
- not accepting the price increase.

This requirement has not resulted in any material improvement to the timeframes or overall process of cost price increase negotiations. Nor have the reporting requirements for price negotiations, via the Code Arbiters, in provision 27B, changed behaviour or improved the timeliness of the process. However, the AFGC recognises that despite the marginal impact of these provisions in prompting behavioural change, they remind retailers of their responsibility to act in good faith towards suppliers and take all reasonable steps to conclude price increase negotiations without delay.

Recommendations for 27A – Price increases:

- *Strengthen protections within 27A to prohibit retailers or wholesalers from requesting commercially sensitive information from a supplier.*
- *Amend 27A to stipulate that cost price increase negotiations are to proceed independently of other retail-led activity such as promotions or media purchase.*
- *Expand 27A (4)'s existing requirements to include a clause preventing retailers from seeking retribution should the supplier choose not to engage in the margin or promotion discussions as part of cost price increase negotiations.*

18 – Funding promotions and 20 – Funded promotions

Promotions are an essential component of the Australian retail landscape, with over 50 per cent of product sold on promotion. They respond to consumer needs, particularly in times of inflation, deliver volume growth and respond to the need to create value. In Australia, suppliers typically fund the vast majority of promotions.

Recently, a concerning behaviour has emerged with retailers seeking assurances from the supplier on price competitiveness in the retail market. This behaviour comprises retailer buyers requesting suppliers to

provide assurances of price competitiveness vis-à-vis other retailers in relation to promotional agreements. Typically, the buyer asks a question such as:

> *"Please confirm it will be competitive to feature [product] at [price] for week commencing [date]".*
>
> *"The [product] has been nominated for brochure, could you please confirm that we'll be competitive to feature this promotion for [date] in line with our 2 week clash guidelines?"*
>
> *"Could you please confirm that we'll be competitive to feature the below SKUs in the brochure for [date] in line with our 2 week clash guidelines?"*
>
> *"We have noticed that [product] has some deep pricing in the market. We have secured catalogue [date]. Will we be competitive to run?"*[7]

More recently, the request has been extended to cover a full week after the promotion:

> *"Any feature in catalogue must be competitive vs. the market, within one week before, during and after."*

This practice seeks to make the supplier responsible for price competition within the retail market, over which they have no control. The AFGC has concerns that this practice is neither in good faith nor reasonable under the Code. Additionally, its impact on the market's natural competitive process raises questions regarding its permissibility under the concerted practice provisions of the *Competition and Consumer Act 2010*. Under section 45 (1)(c) of the Act, parties are prohibited from engaging in "a concerted practice that has the purpose, or has or is likely to have the effect, of substantially lessening competition". The AFGC is further concerned this practice may be in breach of the Act due to the impact on competition of sharing confidential pricing information.

While a promotional plan is typically negotiated between the parties, there are examples of suppliers having a promotion imposed on their business following a retailer realising its price is higher than one of its competitors. In similar cases, retailers might seek 'straight money' (direct payments) from a supplier to compensate for a promotional activity of their competitor. Suppliers often feel compelled to accede as the Code offers little protection. Providing suppliers with the ability to reject promotion requests under these circumstances without fear of retribution would help suppliers to navigate requests of this nature.

In another practice outlined below (under Division 4 (19) Delisting), a retailer might hold a supplier to an agreed promotional plan, even after the supplier informs the retailer that they will not be able to support the promotional activity for reasons outside of their control (such as shipping delays), often resulting in negative repercussions for the supplier. The Code should provide safeguards for a supplier should they, for genuine reasons, need to alter the promotional plans.

Recommendations for 18- Funding promotions and 20 – Funded promotions:

- *Amend the Code's promotions provisions to expressly prohibit a retailer from asking a supplier to comment on market competitiveness.*

[7] Real-world examples provided to the AFGC.

- *Alter the promotions provisions to prevent retailers from requesting compensation of any kind (promotional funding, straight money, or otherwise) in response to the promotional activity of a competitor.*
- *Introduce safeguards for suppliers who need to alter promotional plans, for reasons outside of their control, by adding a 'without retribution' clause to the Code's promotions provisions.*

26 – Product ranging, shelf space allocation and range reviews

The product ranging, shelf allocation and range review provisions seek to establish transparency and certainty for the supplier on the criteria used by the retailer as part of these processes. In reality the criteria are often vague and can be manipulated by the retailer during range review decision making process. The principle of 'consumer first ranging' is often secondary to retail commercial outcomes. Recently, retailers have included retail margin as part of this criteria, making the supplier responsible for maintaining or growing the retailer's profit. This is despite the fact that suppliers do not control the levers that influence sales volume or retail margin such as product positioning on the shelf, product availability in the store, or product price.

The range review process allows suppliers to bring new products to market. Whether imported or locally manufactured, new products can have significant timelines associated with supply chain management or manufacturing investment. Once the product has been accepted, through the range review process, the retailer often requires product delivery that does not account for the circumstances of the supplier, including the significant lead times that may be involved. This can result in the supplier having to make financial decisions and commitments prior to the confirmation the product will be accepted into retailer ranging – another example of risk being pushed onto the supplier.

Prior to commencing the range review, the retailer must provide the supplier with a list of products to be reviewed. To meet the 'reasonable notice' criteria for delisting, retailers initiated a process of highlighting products that do not meet ranging criteria and therefore may be delisted. This practice alerts the supplier to products they should consider as part of the range review process and discuss with the retailers. In reality, a supplier often has their entire product range highlighted as not meeting range review criteria, including products that are market leaders in their categories. This tactic provides a further opportunity for a retailer to renegotiate the commercial criteria of the product and extract further financial support from the supplier.

Following the range review process, the retailer will write to the supplier confirming the review outcomes. By agreeing to the ranging decision, the supplier is expected to sign away their rights to seek a cost price increase until the next range review period, typically 12 months later.

Following the range review process, the retailer will seek financial support from suppliers to assist with the costs of changing the shelf layout. Typically, the retailer will seek a financial contribution from each supplier for what they calculate to be the supplier's percentage of category, even if they have not been impacted by any changes throughout the range review process. It is worth noting that the supplier has no control over the number of changes, the method of calculation or the costs associated. There is no ability to negotiate and no options to use alternate providers.

Recommendations for 26 – Product ranging, shelf space allocation and range reviews:

- *Stipulate that range review criteria are to be agreed at the time of ranging and used consistently throughout the life cycle of the product and prohibit retail margin from being included in ranging criteria.*
- *Prohibit retailers from placing conditions or restrictions on a supplier regarding the timing of cost price increase processes.*
- *Prevent retailers from requiring a supplier to fund ranging-related retail operational costs (e.g. the cost of implementing a change in shelf layout following a range review) and include a 'without retribution' component should a supplier not engage in the practice.*
- *Compel retailers, upon request, to provide suppliers with specific detail regarding why the supplier's products are included on a retailer's list of potential delisted products.*
- *Amend the range review provisions to ensure the retailer has 'due regard for the circumstances of the supplier', such as manufacturing or shipping lead times when implementing range reviews.*

19 – Delisting products

Suppliers view delisting as a tool retailers can employ to pressure them to meet retail demands, or as punishment for not meeting those demands. The Code lists the criteria under which a retailer can delist a product, including failure to meet quality or quantity requirements, failure to meet the retailers' commercial sales or profitably targets, or persistent failure to meet delivery requirements. Standards for quality (including food safety), quantity and delivery requirements are all well understood and reasonably interpreted by the market.

However, the criteria of meeting a retailer's commercial sales or profitability targets is less transparent and more open to interpretation by the retailer. Such commercial considerations are influenced by many factors which are within the control of the retailer and outside the control of the supplier, such as a product's position on the shelf, pricing architecture, store ranging, assortment, or availability. In practice, the criteria for genuine commercial reasons are opaque and manipulated by the retailer to suit their circumstances and do not function as intended. It represents another example of retailers seeking to make suppliers responsible for the retailer's profitability and margins.

There are numerous examples of the delisting clauses failing to adequately protect suppliers in recent years.

As part of negotiations, a supplier will specify a recommended retail price to a retailer. While the shelf price is the responsibility of the retailer, the AFGC is aware of numerous cases in which the retailer increases the shelf price above the recommended retail price. This can result in a decline in sales, leading to retailer-initiated discussions on delisting the product unless the retailer is provided with further financial support such as increased margin.

In recent years the sector has faced considerable supply chain disruptions. This has resulted in difficulties importing raw materials, packaging, processing aids or finished products. In many cases, such interruptions impact the ability to meet demand, particularly when products are scheduled for promotion. Unfortunately, even following supplier advice on the impact of disruptions, retailers have gone ahead with promotional plans, the supplier has not been able to deliver (due the supply disruptions), and as a result

the retailer has delisted the product. In such cases, the retailer has not demonstrated due regard for the circumstances of the supplier.

Once a product is delisted, the retailer will also seek financial support from the supplier for clearing the stock out of the system, this can include funding mark downs, product promotions, or waste.

A supplier has the right to have a delisting decision reviewed by the retailer or wholesaler's senior buyer or the Code Arbiter. The AFGC understands that when a supplier seeks clarification from the senior buyer, they are typically provided with identical information as provided at the time of the initial delisting decision. This clause should be tightened to enable suppliers to attain greater specificity regarding why their product has been delisted.

Recommendations for 19 – Delisting products:

- *Amend the delisting provisions to oblige a retailer to demonstrate due regard for the circumstances of the supplier and act in good faith with regard to delisting decisions.*
- *Prohibit retailer profitability margin as a criterion for delisting.*
- *Strengthen a supplier's right for information regarding a delisting decision, to enable them to receive specific and targeted detail.*

Part 2 – Grocery supply agreements

A grocery supply agreement is not a single document between a retailer or wholesaler and a supplier. Rather the term captures all agreements between the parties, some will be formal documents such as trading terms and others, such as promotional plans, comprise a series of meeting minutes, key decisions and emails.

The complexity of the retail sector, the volume of transactions and the need to interact broadly with many stakeholders has seen retail organisations introduce a range of communication channels including online supplier portals. It is imperative that all commercial activities that may be undertaken through an online supplier portal are in compliance with the Code, in order to ensure appropriate regulation of business conduct. In addition, the onus should be on the retailer or wholesaler to communicate any changes within their portals providing clarity on the specifics of the alteration.

Recommendations for Part 2 – Grocery supply agreements:

- *Introduce a requirement that the terms and conditions associated with the use of any retailer or wholesaler supplier portal must comply with the Code, and oblige a retailer or wholesaler to clearly communicate any changes to the terms and conditions associated with portal usage.*

PENALTIES

This section addresses the following questions from the Interim Report:

Question 12. What level of penalties should apply to breaches of the Code? Please provide reasons.

Question 13. Which provisions, obligations or requirements should be subject to the highest penalties? Please provide reasons.

The AFGC supports including penalties to deter retailers from breaching their obligations under the Code. However, we question whether the scale of penalties proposed in the Interim Report is suitable. While it is evident that the 600 penalty unit ($187,000) maximum penalty currently available under the Competition and Consumer Act 2010 is insufficient to deter breaches, the scale proposed (in line with those available under the Franchising Code) of the greater of:

- $10 million
- 10 per cent of turnover, or
- three times the benefit gained from the breach

could have potentially perverse consequences. While recognising that these figures represent a *maximum* possible penalty, it would nevertheless open up the prospect of Woolworths being penalised almost $5 billion,[8] and Coles in excess of $4 billion.[9] These penalties would make Australia the outlier among those nations with food and grocery codes of conduct. The AFGC is concerned that penalties at this scale could result in unanticipated negative consequences, including:

- functioning as an additional barrier to entry for prospective new entrants into the Australian supermarket retail market, or
- incentivising a retailer facing the prospect of penalisation to use every available means to resist. Given the inevitable legal process would require a supplier to provide evidence without the cover of anonymity, and that this would be a prolonged, expensive and business-jeopardising exercise, this could serve as a disincentive for suppliers to raise complaints in the first instance.

The AFGC recommends adopting penalties at a scale comparable to those available in the UK:

- one per cent of turnover

or New Zealand:

- the greater of:
    - three million NZD
    - the value of any commercial gain realised through the breach, or
    - three per cent of turnover for each accounting period in which the breach occurred.

[8] Based on $48 billion in total food sales in FY23. See https://www.statista.com/statistics/1058341/australia-total-sales-of-food-of-woolworths-group/

[9] Based on $41.5 billion in total sales revenue in FY23. See https://www.statista.com/statistics/1050187/australia-group-sales-revenue-of-coles-group-supermarkets/

We consider that an appropriate level would be the greater of:

- $10 million
- three times the benefit realised through the breach, or
- two per cent of turnover.

Breaches attracting the highest penalties

The AFGC considers it most appropriate to adopt a principles-based approach to determining which breaches should attract the highest penalties that will be available under the new mandatory Code. In furtherance of the goal to centre protections against retribution within the Code articulated in Section 1, and in line with the existing objectives of the Code, the AFGC recommends that the highest level of penalties apply to conduct that:

- constitutes retribution against a supplier
- constitutes a pattern of repeated offences, or
- has a large material impact on a supplier.

PRICE TRANSPARENCY

This section addresses the following question from the Interim Report:

Question 10. Should the grocery supply agreement provide greater transparency around price, such as the process that supermarkets use to determine price? Please provide details to support your views.

The AFGC supports the principle of increasing transparency around the composition of wholesale prices in the food and grocery sector. Wholesale pricing dynamics within the sector are complex, and often characterised by opacity and uncertainty.

AFGC members have indicated that Coles and Woolworths, in particular, frequently add further costs after an initial agreement has already been made on a wholesale price. This practice is often contrasted with Aldi, who can typically be relied upon to uphold an agreement on wholesale price. The impact of the major retailers adding further costs is a reduction in the actual payment received by the supplier when compared to the initial agreement.

The AFGC would support an amendment to the Code to prohibit this practice, with the goal of increasing wholesale price certainty for suppliers. This could take the form of a guarantee that once a commitment has been made to a particular wholesale price, additional retailer ‘asks’ that result in a reduced actual wholesale price for suppliers are impermissible.

State of Industry
2021-22

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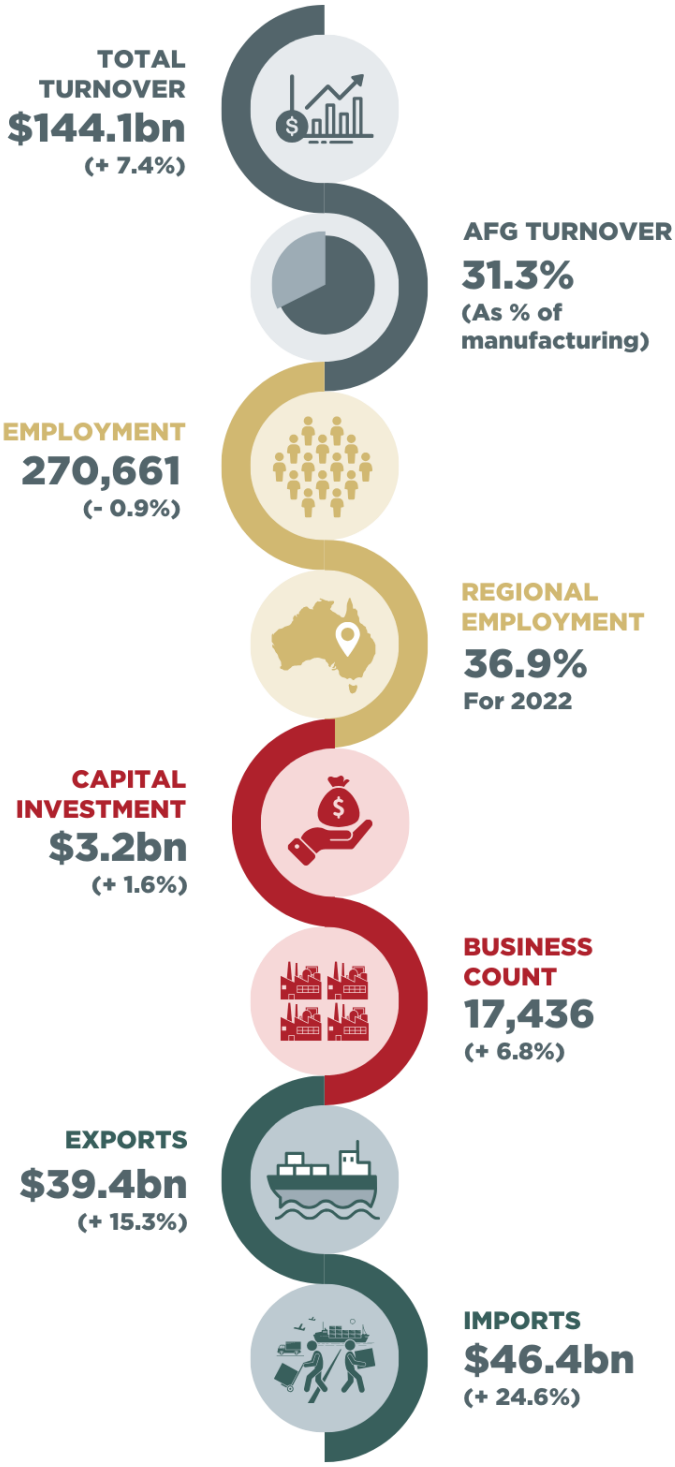

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The figures on this page exclude the fresh food sector and are based on 2021-22 ABS data.

1: This is total number of employees, head count basis and does not include seasonal employees.
2: Gross fixed capital formation for food, beverage and tobacco manufacturing subsector is taken as indicator of capital investment.